No. 92-1538

In the Supreme Court of the United States

OCTOBER TERM, 1993

COLGATE-PALMOLIVE COMPANY
Petitioner,

v.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California in and for the Third Appellate District

AMICUS CURIAE BRIEF ON BEHALF OF THE STATES OF ALASKA, MONTANA, NEW HAMPSHIRE, AND OREGON, IN SUPPORT OF RESPONDENT FRANCHISE TAX BOARD

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In the Supreme Court of the United States

OCTOBER TERM, 1993

No. 92-1839

COLGATE-PALMOLIVE COMPANY
Petitioner,

v.

FRANCHISE TAX BOARD,
AN AGENCY OF THE STATE OF CALIFORNIA,
Respondent.

On Writ of Certiorari to the Court of Appeal of the
State of California in and for the Third Appellate District

AMICUS CURIAE BRIEF ON BEHALF OF THE
STATES OF ALASKA, MONTANA,
NEW HAMPSHIRE, AND OREGON, IN SUPPORT OF
RESPONDENT FRANCHISE TAX BOARD

INTERESTS OF *AMICI CURIAE*

The States that have joined in this *amicus curiae* brief in support of the respondent State of California Franchise Tax Board[1] all have utilized the unitary business principle and formula apportionment to tax the net incomes of multistate and multinational corporations which conduct business in each State. None of the *amici* utilizes the Arms Length/Separate Accounting method for such businesses.

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[1] This *amicus curiae* brief is submitted by the Attorneys General of the States of Alaska, Montana, New Hampshire, and Oregon in support of the respondent State of California Franchise Tax Board. The same *amici* have submitted a separate brief in the companion case of *Barclays Bank PLC v. Franchise Tax Board*, Docket No. 92-1384, which was consolidated with this case by Order of the Court. 62 U.S.L.W. 3319 (U.S. Nov. 2, 1993).

The State of Alaska applies worldwide combined reporting as the required method of income reporting for certain classes of corporate taxpayers,[2] and other of the *amici* States have utilized the worldwide unitary system in prior tax years, or do so pursuant to taxpayer election.[3]

Even States that have in recent years modified their worldwide unitary apportionment formulas nevertheless have significant tax revenues at risk because that formula was applied in prior years for which there are still open tax proceedings. In some cases, these open tax cases date back many years.[4] As a result, cumulatively, billions of dollars are at stake for all the States.[5] Even if it is assumed that the *amici* could make changes in their tax statutes to cure any constitutional defects found by this Court, the matter of their already assessed prior years' taxes might not be resolved by such changes. Thus, the refund claims which are sure to result

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[2] Alaska Stat. § 43.20.072 (1990 & Supp. 1993) applies a version of the worldwide unitary method of apportionment to taxpayers engaged in the production of oil and gas from leases or property within the State of Alaska, as well as to taxpayers engaged in the transportation of oil or gas by pipeline within the State.

[3] Montana utilizes the worldwide combined reporting method, but also has a water's edge election available to taxpayers. Mont. Stat. § 15-31-301 *et seq.* New Hampshire and Oregon both assessed taxes on unitary businesses on a worldwide combined reporting basis prior to 1986. In subsequent years each State has applied a specific "water's edge" formulation. *See* N.H. Rev. Stat. § RSA 77-A, *amended by* RSA 77-A:2-b (Ch. 153:4, New Hampshire Laws of 1986). *See also* Or. Rev. Stat. § 314.363, *amended by* ORS § 317.715 (eff. January 1, 1986).

[4] In the case of Alaska, for example, there are currently pending state tax proceedings under the worldwide unitary method which include up to twelve years of prior tax assessments, dating back to 1982.

[5] All the *amici* have open taxpayer proceedings which involve prior years' assessments under the worldwide unitary method. The dollars at risk in the different States range from a low of approximately three and one-half million dollars to a high of well in excess of five hundred million. California, of course, has already indicated that it stands to lose over four billion dollars in tax revenues if its worldwide unitary tax scheme is invalidated as to both Barclays and Colgate-Palmolive. *Barclays* Supp. Brief, at 1; Resp. Brief in Opp. to Cert. in *Colgate-Palmolive*, at 15.

from a reversal of the California court's decision could disrupt States' finances significantly.

In addition to their direct fiscal interests, the *amici* States all have broader interests in retaining the authority and the flexibility, which has not been circumscribed by Congress, to adopt reasonable unitary apportionment methods and to make changes in their statutory tax structures over time as needed to address their fiscal and administrative needs.[6] Indeed, it was largely because of the administrative difficulties and costs inherent in applying the separate accounting tax method to modern multistate and multinational corporations that almost all States have turned from it to the unitary method for taxing such businesses since World War II.[7] If the Court accepts the petitioner's arguments that national uniformity interests in the separate accounting method now rise to the level of a constitutional requirement, the *amici* States' ability to continue to apply reasonable, cost-effective unitary tax schemes to meet changing business realities would be stymied. The *amici* States joining in this brief have a strong interest in avoiding such a costly and inefficient result.

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[6] *See* 1 J. Hellerstein & W. Hellerstein, State Taxation, ¶ 8.03 at 8-29 (2d ed. 1993) (*hereinafter cited* as Hellerstein Treatise). Individual States have adopted variations and refinements in the formula apportionment model, and, as a result, even though the general rule of the unitary business principle is adhered to by nearly all States, no two State tax laws are completely identical. *Id.*, ¶ 9.06 at 9-23, & n. 72.

[7] The Hellerstein Treatise reports that forty-five of the forty-six States (including the District of Columbia) that levy corporate income taxes have adopted some version of the unitary method and formula apportionment to apply to multistate and multinational businesses. Hellerstein Treatise, ¶ 9.02, Table 9.1 at 9-8; ¶ 9.06 at 9-23. *Amici* have discussed the clear advantages of the unitary method over separate accounting in taxing multistate and multinational corporations in the separate brief they have filed in regard to the *Barclays* petition. *See* note 1, *supra*.

SUMMARY OF ARGUMENT

In their separate brief submitted in the companion *Barclays* petition, *amici* have presented compelling reasons why California's worldwide unitary tax method should be upheld as constitutional under the Foreign Commerce Clause. Colgate raises many of the same arguments as Barclays, but it is on even weaker ground because it is a domestic-domiciled corporation, and thus falls squarely within the holding of *Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983)*, which upheld worldwide unitary taxation as applied to domestic corporations with foreign subsidiaries.

Implicitly recognizing the insurmountable difficulty it faces in overcoming the clear holding in *Container*, Colgate-Palmolive bootstraps itself on the legal arguments presented by Barclays. For without Barclays, Colgate-Palmolive's arguments are foreclosed by *Container*, which was decided on indistinguishable facts.

Thus, if the California Supreme Court's opinion in *Barclays Bank PLC v. Franchise Tax Board*, 829 P.2d 279 (Cal. 1992), is affirmed by this Court, the California appeals court's opinion in *Colgate-Palmolive Co. v. Franchise Tax Board*, 10 Cal. App. 4th 1768, 13 Cal. Rptr. 2d 761 (3d Dist. 1992), also should be affirmed. It is only if the California courts' opinions are reversed that the question of what taxpayer relief is appropriate will need to be addressed. The relief issue is the narrow issue *amici* will address in this brief.

As noted above, the *amici* all have ongoing taxpayer proceedings in their own States involving large sums of tax revenues, which could be jeopardized by a reversal of the California court's decision in *Colgate-Palmolive*. Because the *amici* justifiably relied on this Court's holding in *Container* that the same worldwide apportionment method challenged here was constitutional, the Court's retroactive application of any different constitutional rule announced in this case to other cases still open on review would be particularly unjust and burdensome on the States. Purely prospective application of any "new principle of law" established here is thus both appropriate and necessary.

Finally, even if the Court applies its decision in *Colgate-Palmolive* retroactively, this Court's precedents establish that a remand of the case to the California courts is the proper course to determine what taxpayer relief is necessary consistent with the newly announced constitutional requirements.

ARGUMENT

I. IF *COLGATE-PALMOLIVE* IS REVERSED, THE RULING SHOULD BE APPLIED PROSPECTIVELY ONLY, AND IN ANY EVENT, THE ISSUE OF THE PROPER REMEDY SHOULD BE REMANDED TO THE CALIFORNIA COURTS.

The *amici* States believe that a proper analysis of the issues in both the *Barclays* and *Colgate-Palmolive* petitions, as presented by the respondent California Franchise Tax Board, will result in this Court affirming the California courts' decisions below. In that event, the Court will have no need to reach the separate issue of what relief to provide the taxpayers. However, the fiscal impact on the *amici* States of a reversal in *Colgate-Palmolive* would be so severe and unexpected in light of the clear holding of the *Container* opinion, that the *amici* believe any such decision should be applied prospectively only.

If ever a situation called for purely prospective relief, it is the *Colgate-Palmolive* petition. To adopt petitioner's arguments, this Court would unavoidably have to overrule *Container*. This case thus presents a classic situation for application of the three-part balancing test for prospective application of a newly announced principle of law which was established in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).[8]

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[8] The *Chevron* factors for determining whether a new constitutional rule announced by the Court should only be given prospective application are: (1) the decision must "establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, ... or by deciding an issue of first

(continued...)

If the California court is reversed, it is imperative that the Court address and explicitly decide the prospectivity issue. In *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990), and *American Trucking Assoc., Inc. v. Smith*, 496 U.S. 167 (1990), the Court limited its prior rule on when prospective relief is appropriate following announcement of a new constitutional principle. The Court's subsequent decisions in *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439, 2446 (1991), and *Harper v. Virginia Dept. of Taxation*, 113 S.Ct. 2510, 2517 (1993), eliminated the doctrine of "selective prospectivity," under which a new rule announced by the Court is applied to the litigants before the Court and to all situations arising after the Court's ruling, but the old rule continues to apply to all others whose causes of action arose from facts predating the Court's ruling. *See also* Hellerstein Treatise, ¶ 4.12[4][c] at 4-94.

James Beam and *Harper* also declared that where the Court does not reserve the prospectivity issue, or give its new constitutional rule purely prospective application, "once announced and applied to the parties to the controversy," ... "that rule is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events, regardless of whether such events predate or postdate our announcement of the rule." *Harper*, 113 S.Ct. at 2517; *James Beam*, 111 S.Ct. at 2447. The effect of these recent decisions is to limit the application of the *Chevron* balancing criteria to the issue whether the newly announced constitutional rule should be applied only to events occurring after the date of the decision and, consequently, not to the litigants then before the Court. *See American Trucking*, 496 U.S. at 199-200.

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[8](...continued)
impression whose resolution was not clearly foreshadowed;" (2) the court must "weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation;" and (3) the court must determine whether the new rule, if imposed retroactively, "could produce substantial inequitable results;" if it would, the court may apply the rule prospectively in order to avoid "injustice or hardship." *Chevron*, 404 U.S. at 106-07.

This change in the Court's rule concerning prospective relief poses a serious dilemma for *amici*. They are not parties to the *Colgate-Palmolive* petition; yet if the Court reverses the California court and applies its ruling to the *Colgate-Palmolive* petitioners, under *Harper* and *James Beam*, the decision will also automatically apply to all ongoing taxpayer actions in all States that have ever utilized the worldwide unitary method. This is so even if the Court does not address the prospectivity/retroactivity question at all in its opinion in these petitions.

This possibility is obviously a major concern for States that have relied upon the constitutionality of the worldwide unitary method, expressly upheld in the *Container* decision, and which for years have taxed multinational corporations using that apportionment method. *See, e.g., Allied-Signal, Inc. v. Director, Division of Taxation*, 112 S.Ct. 2251, 2262 (1992) ("State legislatures have relied upon our precedents by enacting tax codes"). If a different constitutional interpretation is now adopted, it will certainly "disrupt settled expectations in an area of the law in which the demands of the national economy require stability." *Allied-Signal*, 112 S.Ct. at 2262. *See also Quill Corp. v. North Dakota*, 112 S.Ct. 1904, 1916 (1992), and the concurring opinion of Justice Scalia, at 1923-24 ("we ought not to visit economic hardship upon those who took us at our word"). Thus, if the Court does reverse the California court in *Colgate-Palmolive*, there are compelling, equitable reasons for the Court to apply the newly announced rule prospectively only.

All three of the *Chevron* prospectivity criteria are easily satisfied in *Colgate-Palmolive*. *See, supra*, note 8. First, the decision would establish a new rule of law undoing more than seventy years of Supreme Court decisions approving the unitary tax method as applied to both foreign and domestic-parent corporations; such a decision would also, of necessity, overrule this Court's express holding in *Container*, upon which States have relied for more than a decade. Second, giving prospective application to such a new constitutional rule in this petition would serve a valid purpose because Colgate-Palmolive still would be relieved of significant tax liability in future years. Third, retroactive application to other tax cases would result in severe "injustice and hardship," not only to

California, but also to all States that have applied the unitary method and have taxpayer proceedings presently pending involving prior years' tax assessments.

As discussed *supra*, retroactive application of a new ruling in *Colgate-Palmolive* could jeopardize billions of dollars in tax revenues which States can scarcely afford to lose at a time when they are having difficulty providing basic services to their citizens. The likely practical effect would be to shift a heavier state tax burden onto purely domestic businesses, which are generally smaller, while the large multinational corporations would have their tax burdens eased.[9] And it would be difficult to replace such significant lost revenues through new or increased taxes, given the States' concern with the need for maintaining tax stability to attract and retain new businesses in a competitive international economy. For all these reasons, the *amici* States urge the Court to apply any new constitutional rule announced in *Colgate-Palmolive* prospectively only, or, alternatively, to reserve the issue and remand it to the California courts for consideration in light of the Court's opinion.

Finally, even if this Court reverses the California court and applies its decision retroactively to the petitioner here, the Court should still remand *Colgate-Palmolive* back to the California courts to consider what specific relief should be granted. That approach would be consistent with *McKesson*, where the Court distinguished between the issue of prospective versus retroactive application of its ruling, which it held to be a question of federal law, and the separate determination of the appropriate remedy to be afforded a taxpayer, which is inevitably intertwined with and involves issues of State law. *McKesson*, 496 U.S. at 39-40.

There are various ways a State could reformulate and enforce its tax laws to satisfy constitutional objections under the Commerce

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[9] 124 Cong. Rec. S18666 (June 23, 1978) (Remarks of Prof. Zeifman in Taxing Multinationals--A CTRA Foundation Analysis: "Relatively small-sized businesses which do not have the advantage of operating across state lines are in the same boat. So, in a sense, the ... proposal to at least partially abolish the unitary method is a way of offering gigantic tax subsidies to non-California businesses at the expense of California businesses and individual taxpayers.")

Clause. *Id.* An appropriate remedy might involve the modification, but not the complete invalidation, of an offending State tax law; it would undoubtedly require development of a more extensive factual record than is now before the Court. A refund of all taxes paid under the tax method might be neither the only nor the most efficacious remedy.

Where, as here, the highest state court below has not addressed the issue of relief, this Court has declared its reluctance to address that issue in the first instance and has instead remanded to the state courts for development of an appropriate factual record and an initial decision concerning relief. *See, e.g., James Beam*, 111 S.Ct. at 2448; *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984). The Court has also held that States should be given flexibility to devise their own remedies to meet new Commerce Clause constitutional requirements concerning State taxation. *McKesson*, 496 U.S. at 39-40, & n. 23. *See also Harper*, 113 S.Ct. at 2519-20; *James Beam*, 111 S.Ct. at 2448. In the event of a reversal, therefore, the *amici* States request the Court expressly to remand the case to the California courts to develop an appropriate record, evaluate State and taxpayer concerns, and fashion an appropriate remedy.

CONCLUSION

For the reasons stated in this brief and in the *amici* States' brief in the companion *Barclays* petition, California's corporate tax, as applied to Barclays and Colgate-Palmolive, is clearly constitutional. Therefore, the *amici* States respectfully submit that the decisions of the California courts in both petitions should be affirmed. However, in the event *Colgate-Palmolive* is reversed, that decision should be applied prospectively only, or the issue should be

reserved and remanded, along with any taxpayer relief issues, to the California courts for their determination in the first instance after developing a more complete record than is before the Court here.

Respectfully Submitted,

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